

# **CALIFORNIA LOTTERY**

Report of Analysis

## **QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION**

*For the Quarter Ended December 31, 2011*



**JOHN CHIANG**  
California State Controller

June 2012



**JOHN CHIANG**  
**California State Controller**

June 22, 2012

California Lottery Commission  
600 North Tenth Street  
Sacramento, California 95811

Dear Commissioners:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to public education for the quarter ended December 31, 2011.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$335,853,949, and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/sk

cc: Gregory Ahern, Commissioner  
California Lottery Commission  
Nathaniel Kirtman III, Commissioner  
California Lottery Commission  
Connie M. Perez, Commissioner  
California Lottery Commission  
John Smolin, Commissioner  
California Lottery Commission  
Phil Tagami, Commissioner  
California Lottery Commission  
Robert T. O'Neill, Director  
California Lottery  
Mike Ota, Deputy Director, Finance  
California Lottery  
Roberto Zavala, Chief Internal Auditor  
California Lottery

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## Report of Analysis

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# Report of Analysis

## Summary

In a letter dated February 21, 2012, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$335,853,949 to the Lottery Education Fund for disbursement to public education. Our review disclosed that the Lottery's accounting records supported this amount and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration. Our analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on March 30, 2012, \$335,853,948.72 (\$0.23 is due to rounding) was transferred to the Lottery Education Fund.

## Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to public education. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer of funds to public education was supported by amounts recorded in the Lottery's accounting records and to determine whether the Lottery is on target to comply with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

## Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, authorized a State-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to public education, and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

Each quarter, the Lottery requests that the SCO transfer net revenues to public education (see Attachment). The Lottery request usually occurs eight to ten weeks after the close of the quarter.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to public education. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public, and not more than 13% be allocated for Lottery expenses. The bill specifies that, of the 87%, not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prizes. In addition, the bill requires the Lottery Commission to establish the percentages to be allocated to the benefit of public education.

## Objectives, Scope, and Methodology

We perform this analysis of the quarterly transfer of funds to public education in order to determine whether:

- Transfer amounts are supported by the Lottery's accounting records; and
- The Lottery is on target to meet the annual allocation requirements specified in the Lottery Act.

We traced the transfer amount to Lottery financial statements and accounting records, and applied analytical review procedures to the lottery fund accounts by comparing them with those from the prior quarter and the prior year. To monitor progress in meeting the annual statutory requirements, we reviewed the actual costs for prizes and administration, as well as the quarterly fund transfer to public education.

## Results

After reviewing the Lottery's unaudited financial statements and supporting records for the quarter ended December 31, 2011, we determined that the Lottery's request to transfer \$335,853,949 to the Lottery Education Fund is supported by formal accounting records.

According to the Lottery's unaudited financial statements, the total amount available for transfer to education was \$613,104,589 for the six-month period ended December 31, 2011. Of this amount, \$277,250,640 (an additional \$4,999,206 withheld from the last quarter of FY 2010-11 pending annual financial statement audit) for the first quarter ended September 30, 2011 was transferred to the Lottery Education Fund on December 29, 2011, leaving a balance of \$335,853,949 for the second quarter ended December 31, 2011, which was transferred to the Lottery Education Fund on March 30, 2012.

The Lottery returned 88.62% of the total revenues from the sales of tickets to the public for the quarter ended December 31, 2011. Of the 88.62%, 58.17% was returned to the public in the form of prizes, and the remaining 30.45% was transferred to public education. The Lottery Act requires the Lottery to return no less than 87% of the total annual revenues from the sales of lottery tickets or shares to the public in the form of prizes and net revenues to benefit public education. The Lottery Commission determines the percentage of total annual revenues to be returned to the public in the form of prizes and to be transferred to public education. However, the percentage of total annual revenues for prizes shall not be less than 50%. All other income and unclaimed prizes were transferred to public education.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

June 22, 2012

## Schedule 1— Summary of Lottery Transfers and Status of Compliance with Statutory Requirements

Fiscal Year 2011-12	Quarter Ended					
	09/30/2011	%	12/31/2011	%	03/31/2012	%
Sales <sup>1</sup>	\$ 869,113,412	100.00%	\$ 1,971,252,588	100.00%	\$	%
Prizes	\$ 494,773,562	56.93%	\$ 1,146,667,271	58.17%	\$	%
Administration	\$ 105,050,044	12.09%	\$ 224,397,328	11.38%	\$	%
Available for Education	\$ 269,289,806	30.98%	\$ 600,187,989	30.45%	\$	%
Prizes and Available for Education <sup>5</sup>	764,063,368	87.91%	1,746,855,260	88.62%		%
Other Income <sup>2</sup>	7,960,834		12,916,600			
Adjustment	4,999,206 <sup>6</sup>		—			
Transfer to Education	\$ 282,249,846		\$ 613,104,589		\$	

Fiscal Year 2010-11	Quarter Ended					
	09/30/2010	%	12/31/2010	%	03/31/2011	%
Sales <sup>1</sup>	\$ 755,772,046	100.00%	\$ 1,588,919,168	100.00%	\$ 2,560,108,514	100.00%
Prizes	\$ 410,400,634	54.30%	\$ 871,070,040	54.82%	\$ 1,414,508,447	55.25%
Administration	\$ 96,130,047	12.72%	\$ 202,106,959	12.72%	\$ 315,783,600	12.34%
Available for Education	\$ 249,241,365	32.98%	\$ 515,742,169	32.46%	\$ 829,816,467	32.41%
Prizes and Available for Education <sup>5</sup>	659,641,999	87.28%	1,386,812,209	87.28%	2,244,324,914	87.66%
Other Income <sup>2</sup>	4,301,850		17,480,033		21,735,572	
Adjustment	4,990,627 <sup>3</sup>		—		—	
Adjustment	(4,462,218) <sup>4</sup>		—		—	
Transfer to Education	\$ 254,071,624		\$ 533,222,202		\$ 851,552,039	

### Annual Statutory Requirements Before AB 142

Prizes = Approximately 50% of sales  
Administration = No more than 16% of sales  
Available for education = At least 34% of sales  
Other income = 100% due education

### Annual Statutory Requirements After AB 142 (enacted April 8, 2010)

Prizes = Not less than 50% of sales  
Administration = No more than 13% of sales  
Prizes and available for education = Not less than 87% of sales  
Other income = 100% due education

Note: The actual percentage allocation is computed on an annual basis when determining whether the Lottery has met the allocation requirements. The percentages shown above indicate the Lottery's year-to-date progress toward meeting these requirements.

<sup>1</sup> Quarterly amounts represent fiscal year-to-date totals.

<sup>2</sup> Includes interest income, other income, and unclaimed prizes.

<sup>3</sup> This amount represents the \$4,990,627 withheld in the fourth quarter of FY 2009-10, pending the financial audit and resolution of accounting issues.

<sup>4</sup> This amount represents the \$4,462,218 from the FY 2009-10 audit adjustment.

<sup>5</sup> AB 142, which amended the Lottery Act, was enacted on April 8, 2010.

<sup>6</sup> This amount represents the \$4,999,206 withheld in FY 2010-11.

**Attachment—  
California Lottery's  
Transfer Request of February 21, 2012**

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700 North Tenth Street  
Sacramento, CA 95811  
calottery.com



February 21, 2012

Mr. Michael Havey, Chief  
Division of Accounting and Reporting  
State Controller's Office  
3301 C Street, Suite 700  
Sacramento, CA 95816

Dear Mr. Havey:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$335,853,949. This figure represents:

Operating income for the six months ended December 31, 2011	\$ 600,187,989
SMIF interest earned	752,918
Other income	55,700
Unclaimed prizes	<u>12,107,982</u>
	<u>\$ 613,104,589</u>
Less: Transfer for the three months ended September 30, 2011	\$ 277,250,640
	<u>\$ 335,853,949</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the six months ended December 31, 2011, prepared from books without audit, for your files.

Sincerely,

*Michael Ota*

Michael Ota, Deputy Director  
Finance Division

Attachment  
cc: Robert O'Neill, Director



CALIFORNIA STATE LOTTERY FUND  
Statement of Revenues, Expenses, and Changes in Net Assets  
For the Six Months Ending December 31, 2011

Lottery sales	\$1,971,252,588
Prizes	1,146,667,271
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Sales after prizes	\$824,585,317
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Less game costs:	
Retailer costs	\$134,303,878
On-line game costs	20,768,624
Off-line game costs	12,225,827
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Total game costs	\$167,298,329
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Income before operating expenses	\$657,286,988
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Operating expenses:	
Salaries, wages and benefits	\$23,678,842
Advertising	17,403,024
Promotion, public relations and point of sale	1,575,832
Other professional services	4,896,762
Depreciation and amortization	2,750,841
Other general and administrative expenses	6,793,698
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Total operating expenses	\$57,098,999
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Operating income	\$600,187,989
Non-operating (expenses) revenues:	
Investment earnings	\$68,070,344
Interest expense imputed on annuitized prize liability	(30,311,992)
Other income	55,700
Allocation to Education Fund	(600,996,607)
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Total non-operating (expenses) revenues	(\$563,182,555)
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Changes in net assets	\$37,005,434
Total net assets-beginning of year	103,016,471
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Total net assets-end of year	\$140,021,905
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Division of Audits  
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